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Minn. Stat. § 480A.08, subd. 3 (2012).*

**STATE OF MINNESOTA  
IN COURT OF APPEALS  
A13-0699**

Diane L. Phillips, individually and as personal representative  
of the Estate of David L. Phillips, Sr.; et al.,  
Appellants,

vs.

David L. Phillips, Jr.,  
Respondent,

Lisa Marie Phillips, et al.,  
Respondents,

Andrea K. Dessler,  
Respondent,

Hi-Tech Floors, Inc.,  
Respondent,

South Properties and Leasing, LLC,  
Respondent,

John Doe, et al.,  
Defendants.

**Filed March 10, 2014  
Reversed and remanded  
Bjorkman, Judge**

Scott County District Court  
File No. 70-CV-11-13131

Peter W. Johnson, Wayzata, Minnesota (for appellants)

Mark J. Schneider, Gary K. Luloff, Chestnut Cambronne PA, Minneapolis, Minnesota  
(for respondents David L. Phillips, Jr., Lisa Marie Phillips, and HTP Floors, Inc.)

Considered and decided by Ross, Presiding Judge; Bjorkman, Judge; and Hooten, Judge.

## **UNPUBLISHED OPINION**

**BJORKMAN**, Judge

Appellants challenge the denial of their constructive-fraud claims, arguing that the district court erred in its application of the Minnesota Uniform Fraudulent Transfer Act (MUFTA), Minn. Stat. §§ 513.41-.51 (2012). Because we agree that the district court erred by failing to treat the grant of a security interest as a “transfer” under the MUFTA, we reverse and remand.

## **FACTS**

For many years, David L. Phillips Sr. (Senior) owned and operated a business that provided concrete floors for commercial construction projects. Appellant Diane Phillips married Senior in 1975 and shortly thereafter began working full-time for Senior’s business. Senior’s son and daughter from a prior marriage, David L. Phillips Jr. (Junior) and Andrea Dessler, also worked for Senior’s business. In the early 1990s, Senior incorporated his business as Hi-Tech Floors, Inc. (Hi-Tech).

In 2005, Senior retired from Hi-Tech. Hi-Tech redeemed Senior’s majority share of common stock and issued Senior a promissory note (stock-redemption note) agreeing to pay the purchase price of \$2,600,000 plus annual interest in monthly installments of approximately \$22,000. Junior became Hi-Tech’s president.

Hi-Tech subsequently experienced financial difficulties. Between January 2006 and July 2010, Junior and his wife, respondent Lisa Phillips, loaned Hi-Tech approximately \$294,355. In June 2008, Hi-Tech stopped making the monthly payments due under the stock-redemption note; neither Senior nor Diane Phillips demanded payment or threatened to enforce the default provisions of the note. And in late February and early March 2010, Senior and Diane Phillips extended two \$30,000 loans to Hi-Tech at Junior's request. Senior died in May 2010.

Hi-Tech's business continued to decline throughout 2010. Junior retired in September and Dessler, as the sole remaining officer, began winding down the business operations. On September 13, Dessler executed a promissory note on behalf of Hi-Tech agreeing to repay Junior and Lisa Phillips the \$294,355 they had loaned the company, secured by an agreement pledging Hi-Tech's fixtures and equipment as collateral. On September 20, Junior and Lisa Phillips filed a UCC financing statement perfecting the security interest.

On October 7, Lisa Phillips incorporated respondent HTP Floors Inc. (HTP). Around that time, she also began aggressive efforts to enforce her security interest, largely through or on behalf of HTP. Lisa Phillips repossessed various items from Hi-Tech in late 2010, including \$112,500 in construction equipment, \$12,635 in office equipment, and \$19,400 in vehicles. And after Hi-Tech sold various assets at auction in November, it paid the net proceeds of \$30,873 to HTP. HTP also serviced several Hi-Tech contracts that Hi-Tech was no longer able to fulfill.

Diane Phillips, individually and as personal representative of Senior's estate, and appellant Sheridan Properties LLC (collectively appellants) commenced this action alleging, in relevant part, that (1) Hi-Tech defaulted under the stock-redemption note and the February and March 2010 loans; and (2) Hi-Tech's grant of the security interest to Junior and Lisa Phillips and Lisa Phillips's and HTP's collection of physical assets and funds pursuant to the security interest were fraudulent transfers voidable under the MUFTA.<sup>1</sup> After a seven-day bench trial, the district court entered judgment against Hi-Tech for a total of nearly \$4.8 million but denied appellants' MUFTA claims. The district court denied appellants' motion for amended findings. This appeal follows.

## DECISION

In an appeal from a bench trial, we view the evidence in the light most favorable to the verdict and will not disturb a district court's findings if there is reasonable evidence to support them. *Rasmussen v. Two Harbors Fish Co.*, 832 N.W.2d 790, 797 (Minn. 2013). But statutory interpretation is a question of law subject to de novo review. *Porch v. Gen. Motors Acceptance Corp.*, 642 N.W.2d 473, 477 (Minn. App. 2002), *review denied* (Minn. June 26, 2002).

The MUFTA permits a creditor to bring an action to void a fraudulent "transfer or obligation." Minn. Stat. § 513.47(a). A transfer is voidable if made with either actual fraud or constructive fraud. *See* Minn. Stat. §§ 513.44-.45; *New Horizon Enters., Inc. v. Contemporary Closet Design, Inc.*, 570 N.W.2d 12, 15 (Minn. App. 1997). Constructive

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<sup>1</sup> Appellants initially asserted claims against Junior and Dessler but declined to pursue those claims after Junior and Dessler declared personal bankruptcy.

fraud is conduct that the law treats as fraudulent, regardless of intent, because it involves transactions that unfairly place the assets of an insolvent debtor beyond the reach of creditors. *See Nat'l Sur. Co. v. Wittich*, 184 Minn. 44, 46-47, 237 N.W. 690, 692 (1931) (comparing circumstantial evidence of fraudulent intent with “fraud in law”). The MUFTA establishes three forms of constructive fraud. Two involve a “transfer made or obligation incurred” by a debtor “without receiving a reasonably equivalent value.” Minn. Stat. §§ 513.44(a)(2), .45(a). And the third involves insider transfers made after a creditor’s claim arose when (1) the debtor made the transfer “to an insider for an antecedent debt,” (2) the debtor was insolvent at the time of the transfer, and (3) the insider “had reasonable cause to believe that the debtor was insolvent.” Minn. Stat. § 513.45(b). But transfers that fall under the constructive-fraud provisions are not voidable “if the transfer results from . . . enforcement of a security interest in compliance with article 9 of the Uniform Commercial Code.” Minn. Stat. § 513.48(e)(2).

The district court found that at the time of the challenged transfers, Lisa Phillips was an insider, Hi-Tech was insolvent, and Lisa Phillips was aware of Hi-Tech’s insolvency. The court further found that in September 2010, Hi-Tech granted Junior and Lisa Phillips a security interest in its physical assets to secure its \$294,355 antecedent debt to them, and starting shortly thereafter, Hi-Tech transferred physical assets and funds to Lisa Phillips (and her company, HTP) in payment for the recently secured antecedent debt. Based on these findings, the district court concluded that the circumstances of Hi-Tech’s transfers of assets and funds to Lisa Phillips and HTP (collectively respondents) establish a *prima facie* insider-transfer claim. But the court

determined that the transfers are not voidable because they were made in “enforcement of a security interest in compliance with article 9 of the Uniform Commercial Code.” *See* Minn. Stat. § 513.48(e)(2). Respondents do not challenge any of the court’s findings or legal conclusions.

Appellants argue that the district court committed legal error by failing to treat the grant of the security interest itself as a “transfer,” rather than enforcement of a security interest. We agree that the district court interpreted the term “transfer” too narrowly. When a statute is unambiguous, we must apply its plain meaning. *Larson v. State*, 790 N.W.2d 700, 703 (Minn. 2010). A “transfer” under the MUFTA includes “every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with an asset or an interest in an asset, and includes payment of money, release, lease, and creation of a lien or other encumbrance.” Minn. Stat. § 513.41(12). As respondents concede, granting a security interest to another plainly falls within this broad definition. Thus, the largely undisputed facts of this case establish two insider transfers for antecedent debt: (1) Hi-Tech’s September 2010 grant of a security interest to Lisa Phillips and Junior and (2) Hi-Tech’s subsequent transfer of physical assets and funds to Lisa Phillips and HTP to satisfy this security interest. The district court addressed only the latter of these transfers.

The failure to treat the granting of the security interest as a transfer undercuts the district court’s conclusion that respondents are entitled to the section 513.48(e)(2) defense. That defense to a constructive-fraud claim applies to transfers made to “enforce[] . . . a security interest.” Minn. Stat. § 513.48(e)(2). The plain language of the

statute does not extend to a circumstance in which the transfer at issue is the granting of a security interest in the first instance. In other words, the statutory defense permits an insolvent debtor to transfer assets or incur obligations to an insider so long as the transfer is based on a pre-existing or contemporaneously granted security interest. But it does not permit an insolvent debtor to grant a new security interest to an insider for antecedent debt.

Even if Minn. Stat. § 513.48(e)(2) were ambiguous, the district court's interpretation is inconsistent with the MUFTA statutory scheme. Under the district court's reasoning, an insider aware of the debtor's insolvency could recover on antecedent debts, thereby obtaining substantial creditor preference, merely because the insider first went through the process of obtaining and perfecting a security interest in the assets. While the formality of a UCC filing affords a certain degree of transparency to such transfers, its impact is, as appellants argue, "too little too late." It simply makes public a transfer already completed and does not remedy the unfairness at the crux of Minn. Stat. § 513.45(b)—that insiders can take advantage of their knowledge as to the extent of the debtor's assets to obtain greater repayment of their antecedent debts than other creditors.

The district court determined that such a result is consistent with caselaw permitting "preferential payment of a preexisting debt to a family member." We are not persuaded. All of the cases the district court cited in support of that proposition predate

the 1987 enactment of Minn. Stat. § 513.45(b).<sup>2</sup> See *Kummet v. Thielen*, 210 Minn. 302, 298 N.W. 245 (1941); *Skinner v. Overend*, 190 Minn. 456, 252 N.W. 418 (1934); *Wittich*, 184 Minn. at 44, 237 N.W. at 690; *Watson v. Goldstein*, 174 Minn. 423, 219 N.W. 550 (1928). And the cases respondents cite are of a similar vintage, see *Nelson v. Poss*, 172 Minn. 149, 214 N.W. 787 (1927); *Aretz v. Kloos*, 89 Minn. 432, 95 N.W. 216 (1903); *First Nat'l Bank of Cold Spring v. Jaeger*, 408 N.W.2d 667 (Minn. App. 1987), or are factually distinguishable because they do not involve transfers to insiders, see *Finn*, 838 N.W.2d at 590. In short, no controlling authority holds that insider creditors aware of a debtor's insolvency may be afforded preference on previously unsecured antecedent debts—conduct plainly prohibited under Minn. Stat. § 513.45(b)—merely by obtaining and perfecting a security interest.

If Hi-Tech had granted Lisa Phillips a security interest to secure its debt to her before becoming insolvent, then the statutory defense in Minn. Stat. § 513.48(e)(2) would have permitted her to enforce the security interest notwithstanding Hi-Tech's insolvency. But she waited to obtain a security interest until she knew that Hi-Tech was insolvent and its assets were rapidly dwindling. Under these circumstances, the MUFTA treats Hi-Tech's grant (and Lisa Phillips and Junior's perfecting) of the security interest as constructively fraudulent. Accordingly, we conclude the district court erred by applying

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<sup>2</sup> The legislature enacted the MUFTA in 1987. The MUFTA largely codifies claims that existed at common law and/or under its precursor, the Uniform Fraudulent Conveyance Act. See generally *Finn v. Alliance Bank*, 838 N.W.2d 585, 592-94 (Minn. App. 2013), review granted (Minn. Nov. 13, 2013). But the insider-transfer constructive-fraud claim in Minn. Stat. § 513.45(b) did not exist before 1987. Compare Minn. Stat. §§ 513.23-.27 (1986) with Minn. Stat. §§ 513.44-.45 (1988).



the defense in Minn. Stat. § 513.48(e)(2) and reverse its denial of appellants' constructive-fraud claim under Minn. Stat. § 513.45(b).<sup>3</sup>

Appellants assert that the appropriate remedy is a judgment against Lisa Phillips and HTP for the amount Hi-Tech owes appellants. We disagree. The MUFTA affords the district court considerable discretion to grant “any . . . relief the circumstances may require,” but such relief must be commensurate with the fraudulent transfer at issue. *See* Minn. Stat. § 513.47 (permitting relief as “against [the] transfer”). How to effectuate relief against the security interest Hi-Tech granted to Lisa Phillips and Junior is not readily apparent from this record. Lisa Phillips enforced the security interest, so it cannot simply be voided under Minn. Stat. § 513.47(a)(1). Appellants therefore are entitled to the amount made unavailable for payment of Hi-Tech's debt to appellants because of the security interest. We remand for the district court to determine that amount and the manner in which appellants are entitled to recover that amount consistent with Minn. Stat. § 513.47(a).<sup>4</sup>

**Reversed and remanded.**

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<sup>3</sup> Because we reverse based on the district court's error in denying appellants' insider-transfer claim, we decline to address their alternative argument that the district court erred in determining “reasonably equivalent value” under Minn. Stat. § 513.44(a)(2).

<sup>4</sup> The MUFTA “permits a judgment to be entered against ‘the first transferee of the asset or the person for whose benefit the transfer was made.’” *New Horizon Enters., Inc.*, 570 N.W.2d at 17 (quoting Minn. Stat. § 513.48(b)(1)). We observe that judgment against HTP is appropriate if the district court finds that HTP is a transferee of the security interest, or that the security interest was made for HTP's benefit.